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## Mythbusting: Why the Critics of Litigation Finance are Wrong

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# MYTHBUSTING: WHY THE CRITICS OF LITIGATION FINANCE ARE WRONG

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## INTRODUCTION

Since the 1990's, more and more litigants have turned to third parties for financial support in meeting their litigation costs. In “alternative litigation financing” (“ALF”), an investor provides a cash payment to a litigant in return for a share of any recovery in the case.<sup>1</sup> As ALF has become more widespread, it has become the subject of significant debate.

Advocates for new forms of litigation funding argue that ALF increases access to justice for parties who have legitimate claims but lack the resources to pursue them.<sup>2</sup> In this respect, making ALF more widely available can help level the playing field in litigation, correcting structural dynamics that have traditionally favored wealthy litigants.

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\* I am so blessed & greatly appreciate the love of my life, M.G.S, for her enduring support and continuously making me a better person every day! Roni lead the Litigation Finance team at TownCenter Partners LLC, Our Mission Is Justice. Roni can be reached at [roni@yourtcp.com](mailto:roni@yourtcp.com). To the *FAMU Law Review*, a heartfelt thank you and gratitude for your efforts, and laser sharp attention to detail. Roni is the Asset Manager at TownCenter Partners LLC, litigation Finance; Our Mission Is Justice who assist Plaintiffs NationWide & International for all case types.

1. Joshua Hunt, *What Litigation Finance Is Really About*, NEW YORKER (Sept. 1, 2016), <http://www.newyorker.com/business/currency/what-litigation-finance-is-really-about> (last visited Oct. 31, 2018).

2. *Id.*

In addition, advocates for ALF point out that permitting third-party investment in legal claims can bring market forces into the judicial system, directing financial resources to the claims with the greatest chance of success.<sup>3</sup>

Critics of ALF contend that such financing methods create various problems: they violate well-established principles of common law about the relationship between litigants and third-parties; they are tantamount to usurious loans; and they threaten the integrity of the judicial system by making it easier for litigants with few resources to bring frivolous lawsuits.<sup>4</sup>

This article discusses both sides of this debate and concludes that the most prevalent criticisms of ALF are based upon misconceptions and myths about the nature of ALF transactions and of the interests of the parties involved in those transactions. When ALF is carefully considered, it is not fundamentally different from a variety of financial arrangements that are widely accepted in different economic contexts. At the most basic level, the investment in a legal claim is much like the purchase of an interest in any other asset.<sup>5</sup> Bringing this kind of financial arrangement into the legal sector may threaten some well-established but outmoded assumptions, but it does not threaten the fundamental objectives of the legal system. To the contrary, ALF allows cases to be decided on their merits instead of being decided by the relative financial power of the parties.

## I. THE BASICS OF ALF

In the broadest sense, ALF refers to a variety of mechanisms by which a litigant receives funds from a third party in return for a share of the proceeds of the case. The litigant may use the funds to cover litigation expenses, including attorneys' fees or discovery costs, expert witness fees, and the like.<sup>6</sup> The litigant may also use the funds to cover its own living or medical expenses during the pendency of the case.<sup>7</sup> This latter approach occurs most often in personal injury cases when the plaintiff's injury causes financial losses that the plaintiff cannot

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3. *Id.*

4. See, e.g., Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 62 (2011) (discussing common law prohibitions against the assignment of lawsuits and maintenance); Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453, 453-56 (2011); Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 643-46 (2007).

5. Hunt, *supra* note 1.

6. *Id.*

7. *Id.*

pay out of his or her own pocket. In most ALF transactions, the third party's investment is "non-recourse," meaning that the third party only receives payment if the litigant has a recovery. If the litigant loses, the third party also loses its investment.<sup>8</sup> In addition, some ALF companies provide funding directly to plaintiffs' law firms; these advances, however, are typically made on a recourse basis.<sup>9</sup>

A wide variety of litigants rely on ALF, including both plaintiffs and defendants. In some cases, the litigants are large, well-heeled business enterprises with valuable claims that wish to manage their litigation risk, and the funders are sophisticated investors whose participation is akin to that of venture capitalists. In other cases, the party receiving funding is an individual with a personal injury claim who needs funds immediately.<sup>10</sup> The one thing that recipients of ALF have in common is the desire to spread the risk of litigation by sharing some of the benefits.<sup>11</sup>

Even as the business of offering ALF has grown dramatically in the last two decades, there is little information on the number of investments made by ALF companies or on the typical amount of investment.<sup>12</sup> Information from a couple of the leading litigation finance companies shows that their average investment is less than \$5000.<sup>13</sup> Other sources indicate that the average investment reflects less than ten percent of the estimated value of the ALF recipient's underlying legal claim.<sup>14</sup> Other ALF companies focus on making much larger investments in much more valuable claims.<sup>15</sup>

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8. *Id.*

9. See STEVEN GARBER, ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES: ISSUES, KNOWN, AND UNKNOWN, RAND INST. FOR CIVIL JUSTICE LAW, FIN., AND CAPITAL Mkts. PROGRAM 13 (2010); Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65, 98-101 (2010); see generally Am. Bar Ass'n Comm'n on Ethics 20/20, *Informational Report to the House of Delegates*, AM. BAR ASS'N 8,6, [http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/20111212\\_ethics\\_20\\_20\\_alf\\_white\\_paper\\_final\\_hod\\_informational\\_report.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf) (last visited Apr. 3, 2017) [hereinafter ABA WHITE PAPER] (distinguishing specialized ALF suppliers that provides loans from ALF companies that purchase claims from clients).

10. McLaughlin, *supra* note 4, at 615-16.

11. ABA WHITE PAPER, *supra* note 9, at 5.

12. Sheri P. Adler, Note, *Alternative Litigation Finance and the Usury Challenge: A Multi-Factor Approach*, 34 CARDOZO L. REV. 329, 331 (2012).

13. GARBER, *supra* note 9, at 12.

14. Adler, *supra* note 12, at 331, n.9.

15. Adam Gerchen et al., *Litigation: The Newest Corporate Finance Tool*, FINANCIER WORLDWIDE (Sept. 2014), [https://www.financierworldwide.com/litigation-the-newest-corporate-finance-tool/#.WGQVErGZP\\_Q](https://www.financierworldwide.com/litigation-the-newest-corporate-finance-tool/#.WGQVErGZP_Q).

## II. ALF INCREASES ACCESS TO JUSTICE

The most important benefit of ALF is that it can increase access to justice.<sup>16</sup> There is no doubt that many less affluent parties face significant barriers to entry to the legal system, regardless of whether they have meritorious claims. According to one estimate, there are only five to six thousand lawyers available to serve the legal needs of more than forty-five million low-income individuals, who might be eligible for some form of legal aid from a public interest organization.<sup>17</sup> Even though lawyers' professional groups call upon all lawyers for a greater commitment to *pro bono* work, an enormous void remains.<sup>18</sup>

This is where ALF comes in. In cases where there are significant financial remedies available to compensate for wrongdoing, the invisible hand of private markets can direct litigation funding to parties who need and deserve it. In this way, litigation funding is not just an instrument for making people wealthy – it is also an important instrument for doing good.

There is nothing novel about the idea that a third party can provide a litigant with something of value so that the litigant can pursue a meritorious legal claim. Advocacy and public interest groups of all kinds have long provided free legal representation to litigants and, in that connection, have also covered the litigant's litigation costs. Long ago, the Supreme Court ruled that there was nothing wrong with this kind of assistance.<sup>19</sup>

For example, in the early 1960's, Virginia enacted a statute that prohibited the "improper" solicitation of legal or professional business.<sup>20</sup> The statute was written broadly enough so that it was unlawful for civil rights groups, such as the National Association for the Advancement of Colored People ("NAACP"), to help plaintiffs who sought to bring lawsuits in order to fight various forms of racial segregation.<sup>21</sup> The NAACP sued, arguing that this statute was unconstitutional.<sup>22</sup> Virginia responded by arguing that the common law had long supported prohibitions on any attempt to stir up or encourage parties to

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16. Hunt, *supra* note 1.

17. David Luban, *Taking Out the Adversary: The Assault on Progressive Public-Interest Lawyers*, 91 CALIF. L. REV. 209, 211 (2003).

18. See, e.g., Jason M. Wilson, Comment, *Litigation Finance in the Public Interest*, 64 AM. U. L. REV. 385, 387 (2014).

19. See NAACP v. Button, 371 U.S. 415 (1963).

20. *Id.* at 419 (discussing Chapters 31, 32, 33, 35 and 36 of the Virginia Acts of Assembly, 1956 Extra Session).

21. See *id.* at 433-35.

22. *Id.* at 417-18.

file or continue litigation. The Supreme Court agreed with the NAACP.<sup>23</sup> In his majority opinion, Justice William Brennan pointed out that “association for litigation may be the most effective form of political association” for minority groups and others who face various forms of government or social oppression.<sup>24</sup> He ruled that “a State may not, under the guise of prohibiting professional misconduct, ignore constitutional rights.”<sup>25</sup> Thus, he concluded that “[w]e hold that the activities of the NAACP, its affiliates and legal staff shown on this record are modes of expression and association protected by the First and Fourteenth Amendments which Virginia may not prohibit, under its power to regulate the legal profession . . . .”<sup>26</sup>

Of course, there is a difference between advocacy and public interest groups like the NAACP and ALF companies. The NAACP’s participation was motivated by a desire to accomplish political and social change, while ALF companies are motivated by the pursuit of a financial return on their investment. But there is no reason to think that this difference will make ALF companies less effective in promoting access to justice. It is axiomatic that an investor cannot make a profit on a frivolous claim that loses. Like advocacy groups, ALF companies need and want to support winning cases. In this respect, they share an objective but have different reasons for pursuing that objective. If this objective permits advocacy groups to promote access to justice, then the same is true for ALF companies.

### III. ALF PROMOTES THE MORE EFFICIENT MANAGEMENT OF LITIGATION COSTS

ALF can also promote greater economic efficiencies for litigants. By giving litigants greater financial resources, ALF permits litigants to direct their own limited resources to the most profitable outlets. Moreover, because they have extensive expertise about the financial side of litigation, ALF companies can provide valuable advice to the litigants they work with regarding how to make the best use of their funding.

These efficiency gains are available to litigants regardless of how many or how few resources they can devote to litigation. A company’s decision to start a lawsuit means that it will have to divert resources that would otherwise go to its own business operations. Addi-

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23. *Id.* at 438-39.

24. *Id.* at 431.

25. *Button*, 371 U.S. at 439.

26. *Id.* at 428-29.

tionally, the costs of litigation are substantial and hard to predict. Of course, there are the direct costs, such as attorneys' fees and discovery costs. But the indirect costs can be just as burdensome, including information, monitoring, transaction, and decision costs.<sup>27</sup>

Litigation financiers can solve or reduce most of these problems. The most common example is when the litigation funder supplies the initial and ongoing investment to cover litigation expenses, eliminating the need for the company to divert its own capital (or credit capacity) from business functions.<sup>28</sup> Moreover, litigation financiers will inform a business plaintiff about the relative strength of the company's case and about realistic settlement options.<sup>29</sup>

Litigation financiers also have the capacity to reduce some of the potential conflict between the interests of the business and those of the law firm. Litigation financiers often have leverage to encourage the law firm to accept a contingent fee, meaning that the firm has the same incentive as the client, to achieve a successful result and cannot count on profiting from a loss with a large hourly fee.<sup>30</sup>

Litigation financing can also allow companies to convert their legal positions into immediately available funds. For example, if a company has won a judgment, but is waiting for appeals to conclude before cashing in, an advance from a litigation funder makes it possible for it to "convert a contingent, intangible asset into cash that can be redeployed into more productive uses."<sup>31</sup> Furthermore, the risk of loss in the appeals process can be minimized or eliminated.<sup>32</sup>

In the end, third-party investment in business litigation presents an enticing trade to business plaintiffs: in return for surrendering the right to a portion of the potential gains from litigation, business plaintiffs can free themselves of all of the underlying risks and costs. Additionally, there is little risk that business plaintiffs will be exploited in making this trade. Because business plaintiffs are sophisticated parties with numerous options, it is unlikely that they will be taken advantage of in making an agreement with the investor. As a result, both the litigation financier and the business can craft an investment relationship that can be mutually advantageous.

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27. See Joanna M. Shepherd & Judd E. Stone II, *Economic Conundrums in Search of a Solution: The Functions of Third-Party Litigation Finance*, 47 ARIZ. ST. L. J. 919, 945-46 (2015); Gerchen, *supra* note 15.

28. Gerchen, et al, *supra* note 15.

29. Shepherd & Stone II, *supra* note 27, at 921.

30. Gerchen et al., *supra* note 15.

31. *Id.*

32. *Id.*

## IV. BUSTING MYTHS ABOUT ALF

The critics of ALF cannot really dispute that these benefits are real, but they insist that the detriments of ALF far outweigh these benefits. Although critics differ in their focus on alleged problems, the most common criticisms are: (1) ALF is a form of lending that imposes usurious interest rates; (2) the availability of ALF will promote frivolous litigation; and (3) the contract between an ALF company and a litigant has the capacity to interrupt the attorney-client relationship or create unnecessary ethical problems for the attorney. When examined closely in light of the increasing experience with ALF, this “parade of horrors” turns out to be more speculative than factual.

A. *Litigation Finance Is Not Usury*

To some critics, ALF is nothing more than the litigation equivalent of payday lending. These critics insist that, at its core, the provision of ALF is a predatory lending practice that exploits personal injury claimants.<sup>33</sup> According to this argument, the fees charged by ALF companies constitute an interest payment, and, as such, they often violate state usury laws.<sup>34</sup> “The financing fees charged by ALF companies are largely unregulated, giving rise to a vociferous outcry among critics who view ALF as a predatory practice aimed at taking advantage of personal injury victims.”<sup>35</sup> This argument is misplaced, however, because it ignores the factual foundation of ALF transactions.

The principal reason for concluding that ALF is not lending is that ALF almost always involves a non-recourse payment to the litigant. That is, the litigant’s duty to repay the advance is contingent, not absolute. This distinction has been widely recognized by courts in different states.<sup>36</sup> For example, in *Kraft v. Mason*,<sup>37</sup> a Florida case, the plaintiff contracted with her brother to fund his legal costs in pursuing an antitrust lawsuit.<sup>38</sup> According to the contract, she would be entitled to the return of the funds she advanced along with interest if her

33. John P. Barylick & Jenna Wims Hashway, *Litigation Financing: Preying on Plaintiffs*, 59 R.I.B.J. 5 (Mar./Apr. 2011).

34. *Id.*

35. Adler, *supra* note 12, at 331.

36. See, e.g., *WRI Opportunity Loans II, LLC v. Cooper*, 65 Cal. Rptr. 3d 205, 212 (Ct. App. 2007); *Fikes v. First Fed. Sav. & Loan Ass’n*, 533 P.2d 251, 263 (Alaska 1975); *Sergeant v. Smith*, 163 P.2d 680, 680-81 (Ariz. 1945).

37. *Kraft v. Mason*, 668 So. 2d 679 (Fla. Dist. Ct. App. 1996).

38. *Id.* at 681-82.



brother won the suit.<sup>39</sup> The brother argued that the funding contract was unenforceable because it violated Florida's usury laws.<sup>40</sup> The court rejected the brother's usury defense because, among other reasons, it concluded that usury law did not apply to a transaction in which the duty of repayment was contingent.<sup>41</sup>

Courts have also held that usury laws do not apply when there is the slightest chance that the obligation to repay will not arise. In *Anglo-Dutch Petroleum International, Inc. v. Haskell*,<sup>42</sup> the ALF recipient argued its duty to repay did not depend upon a true contingency because, at the time when it entered into the ALF agreement, there was no real risk that it would lose the underlying lawsuit. In this connection, the recipient/plaintiff pointed out that the funding occurred after discovery had revealed documents that conclusively established the defendant's liability. In the plaintiff's view, the state of the evidence at the time of the funding made it virtually certain that it would prevail and that it would have a duty to repay.<sup>43</sup> The court rejected this argument by distinguishing between the concepts of "risk" and "contingency."<sup>44</sup> According to the court, an event is contingent if there is any chance that it can occur. The concept of "risk" relates to the likelihood of the contingent event, but a contingency is still present even in a case where the risk of loss is very, very low.<sup>45</sup> Thus, the court declined to apply Texas' usury laws to the ALF transaction.<sup>46</sup>

Some courts have disagreed with these conclusions, however. Recently in *Oasis Legal Financial Group, LLC v. Coffman*, the Colorado Supreme Court held that ALF transactions are subject to Colorado's usury laws, notwithstanding the contingency of the right to repayment.<sup>47</sup> In that case, an ALF company and a litigant entered into an ALF agreement, which provided for a non-recourse advance and was careful to characterize the transaction as a sale of a right to participate in the litigation, not a loan. Nevertheless, the Colorado Supreme Court held that the transaction met the crucial requirements

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39. *Id.* at 681.

40. *Id.* at 682.

41. *Id.* at 684.

42. *Anglo-Dutch Petroleum Int'l, Inc. v. Haskell*, 193 S.W.3d 87 (Tex. App. 2006) (adjudicating an ALF claim related to litigation for misappropriation of trade secrets and breach of confidentiality agreements).

43. *Id.* at 94.

44. *Id.* at 97.

45. *Id.*

46. *Id.*

47. *Oasis Legal Fin. Grp., LLC v. Coffman*, 361 P.3d 400, 401 (Colo. 2015).

of the definition of “loan” for the purposes of the state’s usury laws.<sup>48</sup> In this connection, the court specifically rejected the contention that the transactions did not involve loans because they created only a contingent right to repayment, not an absolute one.<sup>49</sup> The Supreme Court explained:

Litigation finance transactions create repayment obligations—debt—at the outset. That fact is unaffected by the finance companies’ subsequent reduction or cancellation of certain plaintiffs’ obligations. And in eighty-five percent of cases, the companies fully recover. Therefore, in evaluating these transactions, we focus on how they are designed to work and how they actually work most of the time.<sup>50</sup>

Similarly, a New York court has held that an advance to a litigant would be characterized as a loan when there is little or no risk that the litigant will lose. In *Echeverria v. Estate of Lindner*,<sup>51</sup> the plaintiff was a day laborer who asserted a personal injury claim against his employer - after he fell from a scaffold and suffered severe injuries, which necessitated a spinal fusion surgery.<sup>52</sup> The plaintiff obtained an advance from an ALF company to cover the cost of his surgery and other expenses. The fee for the advance was calculated as 3.85 percent of the amount of the advance per month, and the fee was compounded.<sup>53</sup> Given that the defendant was subject to statutory strict liability for the plaintiff’s injuries, the court concluded that the advance had to be characterized as either a usurious loan or an unenforceable gambling contract.

[I]t is ludicrous to consider this transaction anything else but a loan unless the court was to consider it legalized gambling. Is it a gamble to loan/invest money to a plaintiff in a Labor Law action where there is strict liability? I think not. In fact, it might be considered a “sure thing.” In any event, the only gambling allowed in this state is run by the state or on Native American facilities. Thus, it is not a gamble, but a “sure thing,” therefore, it is a loan, not an investment with great risk. If it is a loan, then the interest rate charged is usurious and the court could vitiate the agreement.<sup>54</sup>

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48. *Id.* at 408.

49. *Id.*

50. *Id.*

51. *Echeverria v. Estate of Lindner*, No.018666/2002, 2005 WL 1083704, at \*1-2 (N.Y. Sup. Ct. Mar. 2, 2005).

52. *Id.* at \*1-2.

53. *Id.* at \*2.

54. *Id.* at \*9.

This division of opinion among state courts suggests that accurately characterizing the nature of an ALF transaction may depend upon a factor other than the contingency of the duty to repay. As an alternative to this traditional usury test, tax law offers an analytical method in which courts examine a number of factors to determine whether a particular transaction involves the creation of a debt or an equity interest.<sup>55</sup> The structure of the analysis varies from jurisdiction to jurisdiction, but the fundamental elements are generally consistent.<sup>56</sup> Some courts consider thirteen factors:

- (1) the names given to the certificates evidencing the indebtedness;
- (2) the presence or absence of a fixed maturity date; (3) the source of payments; (4) the right to enforce payment of principal and interest; (5) participation in management flowing as a result; (6) the status of the contribution in relation to regular corporate creditors; (7) the intent of the parties; (8) "thin" or adequate capitalization; (9) identity of interest between creditor and stockholder; (10) source of interest payments; (11) the ability of the corporation to obtain loans from outside lending institutions; (12) the extent to which the advance was used to acquire capital assets; and (13) the failure of the debtor to repay on the due date or to seek a postponement.<sup>57</sup>

The ultimate objective of the test is to determine whether the funds involved in the transaction were placed "at the risk of the business."<sup>58</sup> As the Second Circuit put it, the distinction between debt and equity depends upon "whether the funds were advanced with reasonable expectations of repayment regardless of the success of the venture or [whether they] were placed at the risk of the business."<sup>59</sup>

When this multi-factor analysis is applied to the typical ALF transaction, the weight of the factors indicates that ALF is better characterized as an investment rather than a loan.<sup>60</sup> ALF contracts lack the essential indicia of loans such as promissory notes, fixed maturity dates, fixed interest payments, or rights to enforce repayment.<sup>61</sup> Even

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55. Adler, *supra* note 12, at 340; see also William T. Plumb, Jr., Comment, *The Federal Tax Income Significance of Corporate Debt: A Critical Analysis and a Proposal*, 26 TAX L. REV. 369 (1971).

56. Adler, *supra* note 12, at 340 (citing cases).

57. Adler, *supra* note 12, at 341; see also *Stinnett's Pontiac Serv., Inc. v. Comm'r*, 730 F.2d 634, 638 (11th Cir. 1984); *In re Indian Lake Estates, Inc.*, 448 F.2d 574, 578-79 (5th Cir.1971); *Tyler v. Tomlinson*, 414 F.2d 844, 848 (5th Cir.1969).

58. See *Gilbert v. Comm'r*, 248 F.2d 399, 406 (2d Cir. 1957).

59. *Id.*

60. See Adler, *supra* note 12, at 352-53.

61. *Id.* at 353.

more significantly, the litigant's duty to repay the advance depends upon the success of its "business venture" – that is, the lawsuit.<sup>62</sup>

To be sure, there are some factors that are not consistent with the idea that an ALF contract creates an equity interest. In particular, the ALF company does not acquire any control over the venture.<sup>63</sup> Indeed, rules of legal ethics demand that an attorney receive direction only from the litigant and not from any person or entity providing funds to the litigant. In addition, the advanced funds are not required to be used for the lawsuit itself; in many ALF transactions, the litigants are free to use the advance for any purpose.<sup>64</sup> But when all of the factors are considered, and when one focuses on the question whether the advanced funds are put "at the risk of the business," the best analysis is to treat the ALF transaction as the purchase of an equity interest and not as a loan. Consequently, usury laws would not apply to ALF transactions.

### *B. Litigation Finance Will Not Increase Frivolous Litigation*

Critics of ALF also predict that frivolous lawsuits will increase if litigants can find investors to cover their litigation costs.<sup>65</sup> In addition, these critics also worry that litigation matters will continue too long if parties do not face economic pressure to resolve the case before trial.<sup>66</sup> While these concerns may seem plausible at first glance, they fall apart under close scrutiny.

The principal problem with this criticism is that it is premised on the assumption that ALF will be available to any litigant, regardless of any prospects of success. If ALF companies handed out advances to anyone and everyone, the prediction of increased frivolous litigation might prove prescient but ALF companies are in the business of investing in cases with a real chance of success. If ALF is permitted freely, investment capital will flow to the most meritorious claims, not the most frivolous ones.<sup>67</sup>

There is very little empirical evidence about whether this theoretical prediction about market behavior will be realized. There is,

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62. *Id.*

63. *Id.*

64. *Id.*

65. Lisa A. Rickard, *The Real and Ugly Facts of Litigation Funding*, U.S. CHAMBER INST. FOR LEGAL REFORM (Mar. 26, 2014), <http://www.instituteforlegalreform.com/resource/the-real-and-ugly-facts-of-litigation-funding>.

66. *See id.*

67. *See* Michael I. Krauss, *Alternate Dispute Financing and Legal Ethics: Free the Lawyers!*, 32 MISS. C.L. REV. 247, 260-66 (2013).

however, a limited amount of empirical evidence from other countries supporting the effectiveness of ALF. That evidence suggests that making funding available to litigants will not promote frivolous or long cases.

A recent study from Australia is instructive. Australia has had a robust market for investment in legal claims for over a decade, and data about its judicial system can provide some meaningful information about how litigation finance actually affects the legal system.<sup>68</sup> Two law professors have recently analyzed that data and reached the conclusion that more litigation financing can lead to a somewhat bigger burden for courts, but also to fairer outcomes and better judicial decisions.<sup>69</sup> The study concluded that ALF appears to have had a modest impact on the functioning of courts. In Australian jurisdictions with a larger number of active litigation funders, there is a greater backlog in courts, fewer finalizations, and lower clearance rates.<sup>70</sup> Unsurprisingly, then, court expenditures also increase.<sup>71</sup>

There are good reasons to think that the net effect of ALF is positive, notwithstanding something of an increase in court congestion. Even when the cost of litigation to parties and the courts increases, there can still be an overall social benefit if these longer and more numerous cases produce more economically efficient results. Another benefit of ALF is that it seems to produce more cases that generate published opinions.<sup>72</sup> The Australian data showed that funded cases both cite and receive over twice as many references as unfunded cases. This data suggests that ALF is not just generating more value for plaintiffs and investors, it is making better law.<sup>73</sup>

More encouraging data comes from the Netherlands. Although the Netherlands do not have the same kind of ALF business that is found in the United States or Australia, it recently experienced an increased use of legal expenses insurance.<sup>74</sup> Such insurance, also known as pre-paid legal insurance, covers policyholders against the potential costs of legal action brought by or against the policyholder.<sup>75</sup> The policyholder pays a regular premium and receives a guarantee that certain

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68. David S. Abrams & Daniel L. Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding*, 15 U. PENN. J. BUS. L. 1075, 1106-07 (2013).

69. *See id.*

70. *Id.* at 1106.

71. *Id.*

72. *See id.* at 1105.

73. *Id.*

74. *See* Michael G. Faure et al., *Funding of Personal Injury Litigation and Claims Culture: Evidence from the Netherlands*, 2 UTRECHT L. REV. 1, 19-20 (2006).

75. *See id.*

legal expenses, including attorneys' fees, will be paid on the policyholder's behalf.<sup>76</sup> In this respect, legal expenses insurance can be the practical equivalent of third-party litigation funding in that it relieves a party from the financial risk of engaging in litigation.

The expanding reliance on legal expenses insurance in the Netherlands has not led to a corresponding increase in legal claims, however. Between 1999 and 2003, the number of policies for legal expenses insurance increased by over 30 percent, but the number of personal injury claims remained stable.<sup>77</sup> Thus, even though more Netherlands had an opportunity to sue without bearing the costs of the suit, they did not exploit it.<sup>78</sup>

*C. Litigation Finance Will Not Disrupt the  
Attorney-Client Relationship*

The third primary critique of ALF is that the presence of an ALF company may disrupt the attorney-client relationship.<sup>79</sup> Specifically, critics maintain that the ALF company may take improper control over the litigant's choices or that the ALF company may undermine the attorney-client privilege by seeking confidential information about the case as a condition of funding.<sup>80</sup> Although such problems are possible in theory, it is fairly easy for both lawyers and ALF companies to make sure that there is no disruption in the attorney-client relationship.

With respect to the question of control over litigation, legal ethics rules make it abundantly clear that the attorney's primary duty is to his client and to no other party.<sup>81</sup> This rule provides the primary bulwark against improper control by any third-party who has a financial interest in the outcome of litigation. This rule has worked well for decades in preventing insurance companies from asserting their own interests over and against the interests of their insured who are defendants in lawsuits. There is no reason to think that it will not work equally when applied to ALF companies.

As for the attorney-client privilege, it is true that ALF companies often need to communicate about a case with the attorney for a litigant who seeks funding. The financing company needs an insider's

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76. *Id.*

77. *Id.* at 13-14.

78. *Id.* at 14.

79. *See* Rickard, *supra* note 65.

80. *Id.*

81. *See* MODEL RULES OF PROF'L CONDUCT r. 1.7 (AM. BAR ASS'N 2016).

viewpoint to be able to assess the prospects for success; so, they obtain information about the case from the attorney who is preparing it. In theory, this communication could waive the privilege that protects the attorney's mental impressions and legal theories about the case.

A federal district court in Delaware, however, has rejected that theory in an intellectual property dispute. In *Ioengine, LLC v. Interactive Media Corp.*,<sup>82</sup> Ioengine sought ALF, and its opponent in the case submitted a discovery request for seventy documents prepared by Ioengine's attorney in connection with the due diligence process for ALF.<sup>83</sup> Ioengine resisted the request, and the district court ruled that the documents were privileged, relying on opinions from federal district courts in Texas and Pennsylvania, which addressed similar discovery issues.<sup>84</sup> These rulings suggest that there should be no significant risk of privilege waivers from working with an ALF company, as long as the company, the litigant, and the attorney take reasonable care in deciding what kinds of documents to disclose in the due diligence process.

#### CONCLUSION

Although its critics like to portray ALF as a dangerous novelty, it is neither very new nor very threatening to the integrity of the judicial process. The American judicial system has long been characterized by disparities of power and access to resources. ALF helps to reduce those disparities and give less affluent parties a chance to assure that their lawsuits will be determined on their merits alone. Although there is a theoretical risk of abuse or impropriety in ALF transactions, that risk is present in every aspect of the legal system, including areas that are taken for granted, such as the payment of litigation costs by third-party insurers. In the end, this slight risk is more than outweighed by the benefits that ALF can bring to litigants and the judicial system as a whole.

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82. Order at 2, n.1, *Ioengine, LLC v. Interactive Media Corp.*, No. 14-1571-GMS (D. Del. Aug. 3, 2016) <http://www.delawareiplaw.com/files/2016/08/IOENGINE-14-1571.pdf>.

83. *Id.*

84. *Id.*